Su. Court, U. S.
FILED
DEC 10 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975.

No. 74-1471

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.), A DELAWARE CORPORATION,

Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' BRIEF.

JOSEPH N. MORENCY, JR.,
JAMES T. OTIS,
WESLEY S. WALTON,
JOHN R. F. BAER,
Price, Cushman, Keck, Mahin & Cate,
8300 Sears Tower,
233 South Wacker Drive,
Chicago, Illinois 60606,
312/876-3400,
Attorneys for Petitioners.

Of Counsel:
MILTON V. FREEMAN,
WERNER J. KRONSTEIN,
Arnold & Porter,
1229 Nineteenth Street, N. W.,
Washington, D. C. 20037.

Gunthorp-Warren Printing Company, Chicago • Financial 6-6565

INDEX.

	PAGE
Table of Authorities	iii
Opinions Below	2
Jurisdiction	2
Statutes and Rules Involved	2
Questions Presented for Review	3
Statement of the Case	3
Preliminary Comment	3
The Parties	4
The Transaction	5
Issues Made by the Pleadings	6
Control Issue	6
Market Rigging Issue	6
Fairness Issue	7
Northway's Motion for Partial Summary Judgment	7
The District Court Proceedings	8
Alleged Control of TSC	8
National's Relationship to TSC	9
Alleged Market Rigging	10
Hornblower's Opinion	13
The Seventh Circuit Proceedings	14
Summary of the Argument	15
Argument	16
I. The Standard of Materiality Limits Required Disclosures to Such Information as Is Important to the Reasonable Shareholder or Investor and Has a Significant Propensity to Affect His Judgments	16
A. Materiality Is the Key in Disclosure Standards.	18
B. SEC Uses Materiality as Limitation on Required Disclosures	20

C. Materiality Means Importance and a Strong Likelihood of Impact on the Reasonable Shareholder 24

II. Within This Summary Judgment Record and Under a Proper Test of Materiality, None of the Complained of Omissions Is Material as a Matter of Law 27

A. Omission of a Statement That Stanley R. Yarmuth Was Chairman of the Board of TSC and That Charles F. Simonelli Was Chairman of the TSC Executive Committee Was Not Material 29

B. Omission of Reference to Prior SEC Filings of National and TSC Which Stated National "May Be Deemed to Be a Parent" of TSC Was Not Material 32

C. Omission of Reference to the Hornblower Opinion on Value of National's Warrants Was Not Material 34

D. Omission of Reference to Purchases of National's Common Stock by Madison Fund, Inc. and the Method of Disclosing National's Own Purchases of Its Common Stock Was Not Material 39

Conclusion 43

Appendix

Securities Exchange Act of 1934, § 14(a) ..... a

Securities Exchange Commission
Rule 14a-9 ..... a

Rule 12b-2(j) ..... b

Securities Exchange Commission
Rule 405(a), (f) and (n) c

Federal Rules of Civil Procedure
Rule 56(a), (b) and (c) ..... d

TABLE OF AUTHORITIES.

Cases.

Adickes v. S. H. Kress & Co., 398 U. S. 144 (1970) 28, 38

Affiliated Ute Citizens v. United States, 406 U. S. 128 (1972) 16, 24

Arber v. Essex Wire Corp., 490 F. 2d 414 (6th Cir. 1974), *cert. denied*, 419 U. S. 830 (1974) 26

In re Cady, Roberts & Co., 40 S. E. C. 907 (1961) 26, 27

J. I. Case Co. v. Borak, 377 U. S. 426 (1964) 19, 23

In the Matter of Charles A. Howard, 1 S. E. C. 6 (1934).. 23

Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F. 2d 341 (2d Cir. 1973), *cert. denied*, 414 U. S. 910 (1973) 26

Electronic Specialty Co. v. International Controls Corp., 409 F. 2d 937 (2d Cir. 1969) 26

General Time Corp. v. Talley Industries, Inc., 403 F. 2d 159 (2d Cir. 1968), *cert. denied*, 393 U. S. 1026 (1969) 25

Gerstle v. Gamble-Skogmo, Inc., 478 F. 2d 1281 (2d Cir. 1973) 17, 25

Gordon v. Burr, 506 F. 2d 1080 (2d Cir. 1974) 26

Gulf & Western Industries, Inc. v. Great A. & P. Tea Company, Inc., 476 F. 2d 687 (2d Cir. 1973) 26

Harnett v. Ryan Homes, Inc., 496 F. 2d 832 (3d Cir. 1974) 26

Herpich v. Wallace, 430 F. 2d 792 (5th Cir. 1970) 26

John R. Lewis Inc. v. Newman, 445 F. 2d 800 (5th Cir. 1971) 26

Johns Hopkins University v. Hutton, 422 F. 2d 1124 (4th Cir. 1970) 26, 27

Marx v. Computer Sciences Corp., 507 F. 2d 485 (9th Cir. 1974) 26

In re Merrill Lynch, Pierce, Fenner & Smith, Inc., 1934 Act Release No. 8459; [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,629 (1968) 27

Mills v. Electric Auto-Lite Co., 396 U. S. 375 (1970), *reversing in part*, 403 F. 2d 429 (7th Cir. 1968), *reversing*, 281 F. Supp. 826 (N. D. Ill. 1967) 3, 14, 16, 17, 24, 25

Northway, Inc. v. TSC Industries, Inc., 361 F. Supp. 108 (N. D. Ill. 1973) 2, 8, 9, 10, 12, 14, 39, 41

Northway Inc. v. TSC Industries, Inc., 512 F. 2d 324 (7th Cir. 1975) 2, 14, 17, 24, 28, 29, 30, 33, 36, 39, 41

Robinson v. Cupples Container Co., 513 F. 2d 1274 (9th Cir. 1975) 26

Rochez Bros., Inc. v. Rhoades, 491 F. 2d 402 (3d Cir. 1974) 26

Rogen v. Ilikon Corp., 361 F. 2d 260 (1st Cir. 1966) ... 27

S. E. C. v. Chenery Corp., 332 U. S. 194 (1947) 20

S. E. C. v. Texas Gulf Sulphur Co., 401 F. 2d 833 (2d Cir. 1968), *cert. denied sub nom.*, Coates v. S. E. C., 394 U. S. 976 (1969) 26, 27

S. E. C. v. Transamerica Corp., 163 F. 2d 511 (3d Cir. 1947), *cert. denied*, 332 U. S. 847 (1948) 19

Smallwood v. Pearl Brewing Co., 489 F. 2d 579 (5th Cir.), *cert. denied*, 419 U. S. 873 (1974) 25

Titan Group, Inc. v. Faggen, 513 F. 2d 234 (2d Cir. 1975 26

United States v. Diebold, Inc., 369 U. S. 654 (1962).... 28

Vohs v. Dickson, 495 F. 2d 607 (5th Cir. 1974)..... 26

Federal Statutes, Rules and Regulations.

Federal Rules of Procedure, Rule 56 .....3, 41, d

Investment Advisors Act of 1940, 15 U. S. C. § 80b-1, *et seq.* 20

Investment Company Act of 1940, 15 U. S. C. § 80a-1, *et seq.* 20

Judicial Code, 28 U. S. C. § 1292(b) 1, 14, 15

Judicial Code, 28 U. S. C. § 1254(1) 2

Public Utility Holding Company Act of 1935, 15 U. S. C. § 79, *et seq.* 20

Securities Act of 1933, 15 U. S. C. § 77a, *et seq.* 18-21

Securities Exchange Act of 1934, 15 U. S. C. § 78a, *et seq.* .....1, 2, 7, 16, 18-21, 26, a

Securities and Exchange Commission Rules, 17 C. F. R. § 200, *et seq.*:

Rule 10b-5, 17 C. F. R. § 240.10b-5 .....8, 18, 26, 40

Rule 12b-2, 17 C. F. R. § 240.12b-2 .....21, 26, b

Rule 14a-101 (Schedule A), 17 C. F. R. § 240.14a-101 .....19, 22, 24, 34, 36, 37

Rule 14a-9, 17 C. F. R. § 240.14a-9..... .....2, 14, 17, 18, 21, 22, 23, 27, 29, 40, a

Rule 405, 17 C. F. R. § 230.405 .....2, 21, 26, c

Rule 408, 17 C. F. R. § 230.408 .....21, 26

Trust Indenture Act of 1939, 15 U. S. C. § 77aaa..... 20

Legislative History.

H. R. Rep. No. 85, 73d Cong., 1st Sess. (1933) 18, 19

S. Rep. No. 792, 73d Cong., 2d Sess. (1934) 19

H. R. Rep. No. 1383, 73d Cong., 2d Sess. (1934)..... 19

S. E. C. Releases.

Environmental and Social Disclosure, No. 34-11733, 40 Fed. Reg. 51656 (Nov. 6, 1975) 18, 21
Guides for Preparation and Filing of Registration Statements, No. 33-4936 (1968) 24

Miscellaneous.

I Loss, Securities Regulation 3, 4-7 (2d Ed. 1961) 20
III Loss, Securities Regulation 1431 (2d Ed. 1961) 23
Restatement, Torts § 538 (1938) 23

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975.

No. 74-1471.

TSC INDUSTRIES, INC., A DELAWARE CORPORATION, NATIONAL INDUSTRIES, INC., A KENTUCKY CORPORATION, AND TSC INDUSTRIES, INC. (FORMERLY NAMED NII, INC., AND BEING THE SUCCESSOR TO THE BUSINESS, ASSETS AND CORPORATE NAME OF SAID TSC INDUSTRIES, INC.), A DELAWARE CORPORATION,

Petitioners,

vs.

NORTHWAY, INC., A DELAWARE CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' BRIEF.

This is an action under the Securities Exchange Act of 1934 ("1934 Act") and related rules of the Securities and Exchange Commission ("SEC").

Petitioners (hereinafter "TSC" or "National") request that this Court reverse the decision and judgment of the United States Court of Appeals for the Seventh Circuit (Chief Judge Swygert) which in turn had reversed, on interlocutory appeal pursuant to 28 U. S. C. § 1292(b), the denial by the United States District Court for the Northern District of Illinois (Judge

Richard W. McLaren) of Respondent's motion for partial summary judgment as to the liability of Petitioners. The other defendants, known collectively as the "Schmidt defendants," have no interest in the outcome of this petition.

OPINIONS BELOW.

The opinion of the Court of Appeals is reported at 512 F. 2d 324 (7th Cir. 1975); a copy is included as Appendix A to Petitioners' Petition for Writ of Certiorari. Judge McLaren's Memorandum Opinion and Order of May 21, 1973, denying partial summary judgment as to the liability of Petitioners TSC and National, is reported at 361 F. Supp. 108 (N. D. Ill. 1973); a copy is included as Appendix B to the Petition for Writ of Certiorari. Judge McLaren's Memorandum Opinion and Order of August 10, 1973, amending the foregoing Order of May 21, 1973, is unreported; a copy is included as Appendix C to the Petition for Writ of Certiorari.

JURISDICTION.

The judgment of the Court of Appeals for the Seventh Circuit was entered March 5, 1975. This Court's jurisdiction is invoked under 28 U. S. C. § 1254(1).

STATUTES AND RULES INVOLVED.

The following statutes, rules and regulations are involved in this case:

Securities Exchange Act of 1934, § 14(a), 15 U. S. C. §78n(a).

Securities and Exchange Commission, Rules 14a-9 and 405(a), (f), (n), 17 C. F. R. §§ 240.14a-9, 230.405(a), (f), (n).

Federal Rules of Civil Procedure, Rule 56(a), (b) and (c).

Because the foregoing provisions are lengthy, the pertinent text is set forth in the Appendix to this Brief (a to d).

QUESTIONS PRESENTED FOR REVIEW.

1. Whether "materiality", under the federal securities laws' prohibition against materially false or misleading statements or omissions, requires only a showing of relevancy and possible importance to "some few stockholders," as the Seventh Circuit held, or whether it requires a stronger showing of "significant propensity" to affect shareholders' judgment as this Court stated in *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970).

2. Whether the Seventh Circuit misused summary judgment, and hence improperly foreclosed TSC and National from a trial as to the issue of the materiality of the complained of omissions, by finding such omissions to be material as a matter of law.

STATEMENT OF THE CASE.

Preliminary Comment:

Six years ago on November 12, 1969 Petitioners National Industries, Inc. ("National") and TSC Industries, Inc. ("TSC") issued an 80-page joint Proxy Statement to their respective shareholders (A. 259). Respondent Northway, Inc. ("Northway") was a TSC shareholder. By the Proxy Statement the managements of the two companies sought their shareholders' approvals for the sale of substantially all of the assets of TSC to a National subsidiary in exchange for shares of National Preferred Stock and National Warrants.

On December 4, 1969, the day before the scheduled shareholders' meetings, Northway filed this derivative action attacking the sufficiency of the Proxy Statement (A. 1). Northway

alleged numerous violations of the federal securities laws and related rules and regulations of the SEC. Northway demanded a jury trial and requested injunctive relief to bar the proposed transaction, but Northway never so moved.

On March 6, 1972, Northway filed an Amended, Restated and Supplemental Complaint seeking money damages, restitution and dissembling of the consummated transaction by rescission and other equitable remedies. National and TSC denied its material allegations and sought an adjudication of non-liability. For easy cross-reference, the allegations of the Amended Complaint are fully reproduced as part of the Joint Answer (A. 3).

The relevant proceedings below culminating in this Court's review of the Court of Appeals' judgment reversing the District Court's denial of partial summary judgment are more fully developed hereinafter.

The Parties:

Northway is a private Delaware holding company organized by an individual investor to hold his investments, including 200 shares of TSC (A. 9, 123-24).

TSC was a publicly-held Delaware corporation whose Common Stock and Preferred Stock were listed on the New York Stock Exchange (A. 9, 12). TSC was a retail merchandiser whose principal businesses were the sale to farmers of repair and replacement parts for farm machinery and related farm goods and also the operation of retail self-service stores in the midwestern states. TSC, with approximately 4,400 employees, reported consolidated assets of $68.9 million as of mid-1969 and net sales for fiscal 1968 of $165.2 million (A. 280, 299-305, 313).

National is a diversified, publicly-held Kentucky corporation whose Common Stock and Preferred Stock are listed on the New York Stock Exchange and whose Warrants are listed on the

American Stock Exchange (A. 11). National's products and services mix consists of consumer products, industrial products, retailing, energy products and services and includes among its lines of businesses dairy and ice cream products, soft drink products, retailing, distribution and marketing of petroleum products and steel service centers. As of mid-1969, with approximately 8,000 direct and subsidiary employees, National reported consolidated assets of $235.4 million and for calendar 1968 net sales and operating revenues of $341.3 million (A. 275, 285-98, 313).

The Transaction:

In February, 1969 National had purchased a substantial minority interest in TSC from Charles E. Schmidt, TSC's founder, and his family (A. 379). By October, 1969, through subsequent additional purchases, National had increased its interest in TSC to approximately 34% of TSC's voting securities.

In substance, the transaction described in the Proxy Statement was a taxable swap of listed securities for the remaining 66% of TSC's voting securities. Each TSC stockholder received National securities for his TSC stock, the exchange ratio being .6 share of National Series B Preferred Stock and one National Warrant for each share of TSC Series 1 Preferred Stock. Each share of TSC Common Stock brought .5 share of National Series B Preferred Stock and 1½ National Warrants (A. 268). National's Series B Preferred Stock is entitled to a cumulative quarterly dividend at the annual rate of $1.25 a share and is convertible into .75 share of National Common Stock. National's Warrant entitles the holder to purchase one share of National Common Stock at $21.40 per share until October 31, 1978 (A. 268).

No exchange of National Common Stock was involved in the transaction. Depending upon a TSC stockholder's basis, either a capital gain or loss would be recognized by the stockholder

for federal income tax purposes. National recognized a capital loss (A. 270).

Issues Made by the Pleadings:

Framed as multifarious Proxy Statement deficiencies, Northway alleged a plan by National to buy from TSC all of its assets, business and properties "at a fraudulently low and grossly inadequate consideration and on terms that were otherwise grossly unfair to TSC and the independent stockholders of TSC." National and TSC denied this (A. 20-23, 60). National and TSC responses to Northway's allegations resulted in the following major issues on the pleadings.

Control Issue.

As to Northway's allegations of National control over TSC and concerning the relationship between the two companies, National and TSC denied that actual or working control of TSC had been transferred, or was even transferable, to National at the time National acquired the minority interest in TSC (A. 13-14); that National exercised any power to direct or cause the direction of TSC or that National exercised actual or working control of TSC (A. 18-19); that Stanley R. Yarmuth, President and chief executive officer of National, functioned or acted as TSC's chief executive officer or as an operating officer of TSC at any time (A. 19); and that the proposed transaction was dictated by National without any arm's length bargaining or negotiation between National and TSC (A. 26-27; see also Joint Answer ¶ 14, A. 27-60).

Market Rigging Issue.

As to alleged market rigging of National Common Stock and other alleged manipulations of relative securities values, National and TSC denied that National had been "engaged with" Madison Fund, Inc. in a "series of coordinated purchases" of

National Common Stock (A. 15); that National caused TSC to reduce its apparent income from operations or that the reduction in TSC's reported earnings resulted in a decline in the market prices quoted for TSC's securities which was out of line with the trend in market prices for comparable equity securities during the relevant period (A. 20).

Fairness Issue.

As to the alleged unfairness of the securities exchange ratio, National and TSC denied that the Proxy Statement failed to disclose any material facts concerning the favorable Hornblower & Weeks-Hemphill, Noyes ("Hornblower") opinion bearing on the fairness of the proposed transaction to the TSC stockholders (A. 52) and denied the alleged conflict of interest position of Mr. Blancke Noyes and his firm (A. 51-52).

Northway's Motion for Partial Summary Judgment:

On July 31, 1972, Northway filed its motion for partial summary judgment as to the liability of National and TSC (A. 91). After 2½ years of discovery,[1] Northway confined its motion to a few of its claims under § 14 of the 1934 Act. Its motion charged (i) inadequate disclosure of a change in control of TSC, (ii) non-disclosure of National's relationships to and alleged control of TSC, and (iii) that the Proxy Statement had falsely stated that the TSC Board had approved the proposed transaction. Northway also charged that the Proxy Statement's emphasis on market quotations was misleading because of (iv) non-disclosure of allegedly "coordinated purchases" of National's Common Stock by National and Madison Fund, Inc. and (v) undue emphasis on Hornblower's opinion concerning a "substantial premium over current market values" for the TSC shareholders coupled with non-disclosure of a Hornblower

1. Northway's discovery included 22 depositions upon oral examination exceeding 5,800 pages of transcript, written interrogatories, requests to admit and the production by National and TSC of tens of thousands of corporate documents.

opinion to National on intrinsic value of National Warrants. Northway did not press its Rule 10b-5 claims in its summary judgment motion.

National and TSC did not file a cross-motion for summary judgment. Their opposition to the motion was, in part, grounded on the various discovery papers before the court. In addition, National and TSC filed uncontradicted Opposing Affidavits by Bernard H. Barnett, Charles Evans Gerber, Richard H. Schaefer, Allan B. Solomon, Stanley R. Yarmuth and Bruce Zalman (A. 93-108).

The District Court Proceedings:

In the face of conflicting deposition testimony and the uncontradicted Opposing Affidavits, District Judge McLaren denied Northway's Motion for Partial Summary Judgment in all respects, either because Northway had failed to establish the absence of a genuine issue of material fact or because Northway was not entitled, as a matter of law, to judgment in its favor. 361 F. Supp. at 108. The essentials of the record and Judge McLaren's holdings on issues may be briefly summarized as follows.

Alleged Control of TSC.

The Opposing Affidavits and depositions of Richard H. Schaefer and Stanley R. Yarmuth raised a genuine issue as to whether National was in fact in "control" of the daily management of TSC. In his Opposing Affidavit Mr. Schaefer stated that he was President and chief administrative officer of TSC and a member of the TSC Board. He said that at all times he possessed and exercised operational control of TSC and that he was directly responsible, and exclusively accountable, to the TSC Board for the orientation and implementation of all corporate policies. Mr. Schaefer further said that all other officers and employees of TSC reported to him exclusively and he, in turn,

reported exclusively to the TSC Board. In short, it was Mr. Schaefer who led negotiation of the transaction for TSC (A. 102).

And in his deposition taken by Northway on December 23, 1969 Mr. Schaefer testified that, while under the TSC by-laws the Chairman of the Board was the chief executive officer, he really functioned as the chief executive officer (A. 180, 195-96).

In his Opposing Affidavit Mr. Yarmuth said that although he had become Chairman of the Board of Directors of TSC in March, 1969 he had "never acted as its chief executive or chief administrative officer" (A. 105). In his deposition taken by Northway on September 10, 1971 Mr. Yarmuth testified that in his conversations with Mr. Schaefer in early 1969 concerning the management of TSC he was concerned "with Mr. Schaefer staying with the company and continuing his management"; that it was hoped that Mr. Schaefer "would remain as chief executive officer"; and that Mr. Schaefer's "office would be chief executive officer" (A. 251).

Referring to the foregoing Judge McLaren said (361 F. Supp. at 111):

> "The affidavit and deposition testimony show that Shaefer [sic] managed TSC without consulting with or answering to National. This creates an inference, to which defendants are entitled in opposing a motion for summary judgment, that National was not in control of TSC.
>
> * * * * *
>
> Thus, viewing the evidence and the inferences therefrom in the light most favorable to defendants, the Court holds that plaintiff has failed to establish the absence of a genuine question of fact as to the material issue of whether National was in control of TSC."

National's Relationship to TSC.

Northway claimed that the Proxy Statement failed to adequately disclose the relationship between National and TSC. The essential points on this issue were lack of a recital that

Yarmuth was Chairman of TSC's Board and Simonelli was Chairman of its Executive Committee and absence of a reference to prior reports to SEC which stated National may be deemed a parent of TSC. On this issue Judge McLaren saw the "pivotal question" on the summary judgment motion to be whether the facts "relating to the relationship between TSC and National which were omitted from the joint proxy statement were, as a matter of law, material." 361 F. Supp. at 112. Judge McLaren could not conclude that these (as well as other claimed omissions) were material as a matter of law. Judge McLaren stated (361 F. Supp. at 114):

> "In passing on plaintiff's motion for partial summary judgment, the Court has considered the omitted facts in light of the manner in which other facts were disclosed which could have alerted the TSC shareholders to the possible bias of the management and board of TSC. . . . While the Court believes that the prior claims of control made to the SEC and Yarmuth's and Simonelli's other positions might have been considered important by TSC shareholders, it cannot conclude that these facts were so obviously important to them that reasonable minds could not differ on the issue; that is, as to whether they would have a significant propensity to affect the voting process."

Alleged Market Rigging.

As to Northway's several assertions that National "engaged with" Madison Fund, Inc. in a "series of coordinated purchases" of National Common Stock (A. 14, 38), there was no evidence in the summary judgment record before Judge McLaren that either National or Madison Fund, Inc. had any foreknowledge at any time of a proposed market purchase of National Common Stock by the other, or that either had any schedule, plan or program for the purchase (or not to purchase) from time to time of National Common Stock.

Mr. Yarmuth stated in his Opposing Affidavit that at no time did he have any advance knowledge of any market transaction

in National Common Stock by Madison Fund, Inc. He said that his sole knowledge of any transaction by Madison Fund, Inc. in National's Common Stock was after the fact and was derived from his observation of stock transfer reports shown to him from time to time by Mr. Solomon, Vice President of National. Mr. Yarmuth said that he had no knowledge of any plan, program, schedule or formula of Madison Fund, Inc. for the purchase of National Common Stock (A. 105; see also 256-57).

To like effect are the Opposing Affidavit of Allan B. Solomon and his deposition testimony that he became aware of Madison Fund, Inc. purchases of National Common Stock through his receipt and review of transfer sheets from time to time (A. 103; 225-26) and the Opposing Affidavit of Bernard H. Barnett, Chairman of the National Board and a director of Madison Fund, Inc., who stated that all of his knowledge of National Common Stock purchases by either Madison Fund, Inc. or National was gained after the fact (A. 93).

As to Northway's varied assertions as to market rigging, security values and comparative values of National and TSC securities (A. 14-15, 20-22, 34, 37, 44) there simply was no evidence in the summary judgment papers before Judge McLaren that National, or anybody else at any relevant time, was engaged in any effort in the market to buy any National securities which would be involved in the securities swap—*i.e.*, National Series B Preferred Stock and National Warrants.

Nor was there any evidence before Judge McLaren that National purchased any of its Common Stock in the market after September 17, 1969, until almost two weeks after the shareholders' meetings which voted approval of the proposed transaction. Mr. Yarmuth stated in his Opposing Affidavit that early in 1969 he made the decision that National would purchase some of its own stock in the open market and he personally directed the placement of each order to purchase until September 17, 1969 and that each such decision was made by him (A. 106). In their Joint Answer National and TSC affirma-

tively alleged that the only open market purchases of its own Common Stock made by National during the entire year 1969 were the limited number of transactions during the period March 25, 1969, through September 17, 1969 and two transactions on December 18 and December 23, 1969 all of which are shown, together with daily and monthly trading volume figures on Exhibit A attached to the Joint Answer (A. 54, 90). See also Opposing Affidavit of Bruce Zalman and related charts (A. 107, Chart facing 108).

Before Judge McLaren, Northway argued that the value of the National Series B Preferred Stock and the National Warrants was "directly and immediately dependent upon the value of the National Common." But the deposition testimony of Northway's own expert, Professor Erwin E. Nemmers, showed that he treated the National Warrants as "highly speculative" and that he indulged in at least three different identifiable exercises trying to value the Warrants (A. 15, 538). In his deposition testimony Mr. Noyes refused to regard the value of the Warrants as "dependent" on the price of the Common Stock (A. 140). And as to the National Series B Preferred Stock, the deposition testimonies of Professor Nemmers, Mr. Noyes and Mr. William E. Stiegelmeier established that the determinative factors bearing on value were the stock's dividend, yield and/or coverage (A. 136, 160-63, 199-201).

Again, recognizing the requirements of Rule 56 of the Federal Rules of Civil Procedure, Judge McLaren stated (361 F. Supp. at 116):

> "Although plaintiff's evidence shows the opportunity for coordination, and the inference that might be drawn from its evidence might support a finding of coordination, the Court is not free to draw such inferences. Thus, defendants' evidence succeeds in raising a genuine issue of fact as to whether the Madison purchases were coodinated [sic] with National's."

Hornblower's Opinion.

Northway also attacked the sufficiency of the Proxy Statement for its failure to disclose that Hornblower considered that the National Warrants had a value of approximately $3.50 each as compared with the November 7, 1969 closing price on the American Stock Exchange of $5.25 each as reported in the Proxy Statement (A. 519; 271). In substance, Northway asserted that the October 31, 1969 letter was at variance with the Proxy Statement's reference to "the substantial premium over current market values represented by the securities being offered to TSC stockholders" as being one of the factors considered by Hornblower in rendering a favorable opinion as to the fairness to the stockholders of TSC of the terms for the exchange of the shares of TSC for securities of National (A. 267; 35, 52).

The evidence before Judge McLaren on the summary judgment motion also included the minutes of the TSC directors' meeting of October 16, 1969 and the Hornblower opinion letter of the same date to the TSC Board which was attached as Exhibit A to the minutes (A. 427). The relevant paragraph of the October 16, 1969 opinion letter to TSC reads:

> "To arrive at our opinion we considered, among other things, the current market prices of the securities of both companies, the high redemption price of National Industries' Series B Convertible Preferred, the dividend and debt service requirements of both companies, the substantial premium over current market values represented by the securities being offered to TSC shareholders, and the increased dividend income."

The relevant portion of the TSC October 16, 1969 minutes states (A. 413):

> "The directors then discussed the appraisal report of October 16, 1969 from Hornblower & Weeks-Hemphill, Noyes. Mr. Yarmuth stated that under the original proposal from National, the stockholders of the corporation

would have received fewer shares and warrants than now proposed. Mr. Noyes then explained the analysis supporting the appraisal and stated that the present offer represents more than 40% premium to the corporation's stockholders based on current market values. Mr. Noyes stated that Hornblower & Weeks-Hemphill, Noyes suggested the present terms as being a fair offer and that National accepted such proposal without any negotiation. Mr. Noyes stated that his firm appraised the National $1.25 Series B Preferred as a sound value and that even though there may be some decline in the price of the warrants, the exchange offer is a fair one."

Confronted with the foregoing Judge McLaren concluded (361 F. Supp. at 116):

"Plaintiff bases its criticism of the failure to disclose that Hornblower relied upon a warrant value of $3.50 on its assertion that the use of this figure results in a very small premium, rather than the substantial one claimed. There is no evidence in the record of which the Court is aware to support this assertion. The truth of this assertion and the adequacy of the disclosure of the condition remain to be determined by the finder of fact and summary judgment on these grounds is thus precluded."

The Seventh Circuit Proceedings:

The Court of Appeals for the Seventh Circuit, entertaining an interlocutory appeal from the summary judgment denial pursuant to 28 U. S. C. Section 1292(b), reversed on the issues of liability and remanded the action for further proceedings. 512 F. 2d 324. The Seventh Circuit held that the Proxy Statement violated SEC Rule 14a-9 and expressly rejected this Court's approach in *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375 (1970) that omissions in a proxy statement are material only if they have a "significant propensity" to affect the shareholder voting process. In the Seventh Circuit's view materiality of any facts could be determined without regard to their propensity to affect the voting process. The critical test of materiality is

"relevancy alone," even if possibly "relevant for some, but not for others." 512 F. 2d at 331 & n. 13.

Acknowledging that its test of materiality would require many facts to be stated in a proxy statement which might not come within the scope of this Court's "stricter 'significant propensity' test" applied by Judge McLaren, 512 F. 2d at 330 & n. 11, and while agreeing with Judge McLaren that "control" by National of TSC had not been demonstrated in the summary judgment papers, the Seventh Circuit held that four omissions complained of by Northway and not found by Judge McLaren to have been material as a matter of law, were so important that "reasonable minds could not differ on the question of materiality." 512 F. 2d at 329.

SUMMARY OF ARGUMENT.

1. Full and fair disclosure requires only good faith and fair presentation of that which is important to the reasonable shareholder and investor. Materiality limits required disclosures to those important matters which have a real likelihood of influencing their decisions. Only when omitted information is so important that its non-disclosure renders a proxy statement false and misleading is its omission violative of Rule 14a-9 of the proxy rules. The Seventh Circuit's novel test of materiality would distort the disclosure standards and impose serious liabilities for omission of relevant details having little or no significance in corporate democracy.

2. The District Court correctly recognized that there were real disputes on important fact issues and serious gaps in the record which precluded granting summary judgment. The Seventh Circuit brushed aside those serious factual conflicts and improperly drew questionable inferences in violation of Rule 56 of the Federal Rules of Civil Procedure.

This Court should reverse and remand this action to the District Court for trial by jury.

ARGUMENT.

I.

The Standard of Materiality Limits Required Disclosures to Such Information as Is Important to the Reasonable Shareholder or Investor and Has a Significant Propensity to Affect His Judgments.

This case marks the first time this Court is presented squarely with the issue of what is the proper standard for materiality under the federal securities laws. *Mills* actually involved questions with respect to causation and its role in establishing a violation of Section 14(a) of the 1934 Act. Materiality of the calculated concealments which rendered the *Mills* proxy statement violative of basic shareholder rights had been found in the District Court, affirmed in the Court of Appeals and was unquestioned when the case was considered by this Court.

In *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128 (1972) this Court considered whether it should be necessary for the defrauded Indians to prove that they would not have sold their valuable rights had they known that the bank officials were cheating them by paying less than the real market price and, in addition, were dual agents who represented the purchaser while purporting to act for the Indians as sellers. There was no question as to the materiality of the failure of the bank officials to reveal a higher current price and their dual agency—everyone saw that as gross and palpable fraud.

Other courts (including the Seventh Circuit) have looked to *Mills* and *Affiliated Ute* for guidance in determining the materiality of omissions or misstatements under the securities laws, but in both those cases justice required that actual proof of causation be excused once the materiality of the misstatement or omission is plainly and clearly shown. Neither case supports the strange inference drawn by the Seventh Circuit that because probability is not an element of causation, it is, *a fortiori*, not

an element of materiality. Quite the contrary, this Court's emphasis on "significant propensity" in *Mills* and its recognition of the palpable fraud practiced on the Ute Indians indicates strongly that once the requirement of proof of causation is eliminated, the standard for establishing materiality becomes all the more important.

Full and fair disclosure under the securities laws requires only good faith and fair disclosure of that which is important—nothing more. Otherwise closed transactions would be subject to rescission or the award of substantial damages because of insignificant defects.

The Seventh Circuit adopted its new "might" test on the basis of its singular and narrowly focused reliance on this Court's statement in *Mills* that a determination of the materiality of misstatement or omission "embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote." This quoted language immediately precedes this Court's clarifying statement that "[t]his requirement that the defect have a significant *propensity* to affect the voting process is found in the express terms of Rule 14a-9. . . ." 396 U. S. at 384. The Seventh Circuit, in adopting its "might" test, repeatedly contrasted its approach with the contrary interpretation given to *Mills* by Judge Friendly in the Second Circuit's decision in *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281, 1302 (2d Cir. 1973). 512 F. 2d at 330, 331 & n. 13.

Since this Court has not heretofore considered directly a standard or definition of materiality under securities laws, a brief review of legislative history and the role of SEC in rulemaking under the federal securities laws seems appropriate.

A.

Materiality Is the Key in Disclosure Standards.

The concept of materiality pervades all of the disclosure and fraud provisions of the federal securities laws. Similar concepts of materiality are applicable to misstatements or omissions in registration statements under the 1933 Act and to untrue statements or omissions of material facts under Rule 10b-5 which prohibits fraud in connection with the purchase or sale of securities.[2] Therefore any analysis of materiality cannot be limited to Rule 14a-9 but must extend to the comparable provisions of the 1933 Act from which Rule 14a-9 was derived and to Rule 10b-5 which, though subsequently adopted, has been the subject of a great deal of litigation and comment.

The Securities Act of 1933[3] ("Securities Act") and the 1934 Act[4] mandate full and fair disclosure of material information as a guiding principle. Disclosure is limited to such matters as are either necessary to discharge the SEC's obligations under the Acts or necessary or appropriate in the public interest or for the protection of investors.[5]

The Securities Act was enacted in response to the flotation during the post-World War I decade of $25 billion of securities which proved worthless.[6] The significance of the enumerated disclosure items in Schedule A to that Act (detailing required

2. Rule 10b-5 was issued under § 10(b) of the 1934 Act. See p. 26 n. 18.

3. 15 U. S. C. § 77a *et seq*. The sections of the Act are identified by the letters a-bb rather than by the corresponding Arabic numbers.

4. 15 U. S. C. § 78a *et seq*. The sections of the 1934 Act are identified by the letters a-jj rather than by the corresponding Arabic numbers. Recent amendments to the 1934 Act, adopted this year in P. L. [illegible]-29, have not as yet been included in this codification.

5. A significant portion of the text on pages 18-24 is taken directly from Release 34-11733; File No. S7-593, Environmental and Social Disclosure, 40 Fed. Reg. 51656 *et seq*., Nov. 6, 1975.

6. H. R. Rep. No. 85, 73d Cong., 1st Sess. at 2 (1933).

content of registration statements) is essentially economic in nature. As the House Report which preceded the Securities Act states:

> "The type of information required to be disclosed is of a character comparable to that demanded by competent bankers from their borrowers, and has been worked out in light of these and other requirements."[7]

Liability for material false or misleading statements flows from violations of Sections 11, 12(2) and 17 of the Securities Act and Sections 10, 14 and 18 of the 1934 Act.

Section 14(a) of the 1934 Act provides that proxies may be solicited only in conformity with "such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." The Congressional purpose in enacting Section 14 has been characterized as "to require fair opportunity for the operation of corporate suffrage."[8]

The Congressional intent in creating liabilities based on the omission of information which makes the registration statement misleading is further clarified by the derivation of this concept. Professor Loss has observed: "[T]he Securities Act of 1933 did not spring full grown from the brow of any New Deal Zeus"

7. *Id*. at 4. In a recent speech, Ray Garrett, Jr., former Chairman of the SEC, ably summarized the Congressional purpose in adopting the disclosure requirements in Schedule A when he said:

> "In adopting Schedule A, Congress obviously posited as the typical prospective investor, a reasonable economic man whose needs and desires for information were basic, financial stuff: balance sheets and earnings statements, capital structure, rights of security holders, especially of the securities being offered, a description of the business, major customers and contracts, litigation that might be costly, etc." Ray Garrett, Jr., Uses of Disclosure, National Investor Relations Institute, September 30, 1975.

8. S. Rep. No. 792, 73d Cong., 2d Sess. at 12 (1934). H. R. Rep. No. 1383, 73d Cong., 2d Sess. at 13-14 (1934); see also *Securities and Exchange Commission* v. *Transamerica Corp*., 163 F. 2d 511, 518 (3d Cir. 1947), *cert. denied*, 332 U. S. 847 (1948), and *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 431-32 (1964).

—neither did the concept of materiality which is at the heart of the disclosure requirements of the 1933 Act. The legislative history relied strongly on English decisions relating to materiality, particularly material omissions under the English Companies Act, which long before the 1933 Act prohibited and made actionable material misrepresentations in prospectuses.[9]

B.

SEC Uses Materiality as Limitation on Required Disclosures.

In administering the various federal securities laws,[10] the SEC was expected to become entirely familiar with the securities markets and to develop an expertise which would enable it to resolve questions such as what disclosure of information regarding securities and issuers is necessary to discharge the SEC's responsibilities under the Securities Act and the 1934 Act[11] or is "necessary or appropriate in the public interest or for the protection of investors."[12] SEC has discretion to require specific

9. I Loss, *Securities Regulation* (2d Ed., 1961) pp. 3, 4-7.

10. The SEC's organic statutes include:

Securities Act of 1933, 15 U. S. C. § 77a *et seq.*

Securities Exchange Act of 1934, 15 U. S. C. § 78a *et seq.*

Public Utility Holding Company Act of 1935, 15 U. S. C. § 79 *et seq.*

Trust Indenture Act of 1939, 15 U. S. C. § 77aaa *et seq.*

Investment Company Act of 1940, 15 U. S. C. § 80a-1 *et seq.*

Investment Advisors Act of 1940, 15 U. S. C. § 80b-1 *et seq.*

11. SEC's general rulemaking authority is found in Section 19(a) of the Securities Act and Section 23(a)(1) of the 1934 Act, which authorize SEC to promulgate such rules "as may be necessary to carry out the provisions of this title," and "as may be necessary or appropriate to implement the provisions of this title for which [it is] responsible or for the execution of the functions vested in [it] by this title . . .," respectively.

12. The courts have repeatedly recognized broad discretion in the SEC to make determinations whether to take action and the form any action should take, dependent on its expertise in securites matters. See *e.g., Securities and Exchange Commission* v. *Chenery Corp.*, 332 U. S. 194, 209 (1947).

kinds of information to be disclosed in proxy statements even though each and every one of such items of information might not be material.

Whether particular disclosure requirements are necessary involves a balancing of competing factors.

> "As a practical matter, it is impossible to provide every item of information that might be of interest to some investor in making investment and voting decisions.
>
> * * * * *
>
> The weighing of these factors, among others, is the mechanism by which disclosure is rendered fair as well as full. . . ."[13]

The SEC has generally resolved these various competing considerations by requiring disclosure only of such information as the SEC believes is important to the reasonable investor—"material information."[14] 17 C. F. R. §§ 230.405(1), 230.408, 240.12b-2(j), and 240.14a-9(a). Using materiality as a limita-

13. SEC Release, 34-11733; File No. S7-593 Environmental and Social Disclosure, 40 Fed. Reg. 51656, at 51659-60, Nov. 6, 1975. Participants in a 1975 SEC proceeding on Environmental and Social Disclosure (File No. S7-593) suggested more than 100 topics concerning which they desired disclosure. A disclosure document which incorporated each of these suggestions would consist of excessive and possibly confusing detail, whether provided directly to investors or filed with the SEC for inspection by interested persons.

14. Rule 405(1) under the Securities Act provides:

> "The term 'material', when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered."

Rule 408 provides:

> "In addition to the information expressly required to be included in a registration statement, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading."

Rule 12b-2(j) under the 1934 Act is worded substantially the same as Rule 408 above.

tion is necessary in order to insure meaningful and useful disclosure documents of benefit to investors generally without unreasonable costs to registrants and their shareholders.

The proxy rules specify in considerable detail which information is required to be disclosed. In Schedule 14A, which consists of 22 separate items, SEC has prescribed the information which must be provided to shareholders in connection with solicitation of their proxies with respect to the various specified matters. Item 14 of Schedule 14A specifies the information which must be included in a proxy statement if action is to be taken with respect to "mergers, consolidations, acquisitions, and similar matters." Item 15 details the financial statements which must be incorporated in a proxy statement seeking approval for a merger, acquisition or certain other matters. Neither of the courts below held that the Proxy Statement issued jointly by National and TSC failed to include any of the detailed information required by Schedule 14A.

Rule 14a-9 fits into this scheme in that it prohibits false and misleading statements and prohibits the omission of statements required in order to avoid making false and misleading the specified items which Schedule 14A requires to be included in the proxy statement. It provides:

> "No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

Accordingly, the question whether an omission is "material" must be analyzed in terms of whether it so seriously distorts the information contained in the proxy statement that the proxy

statement becomes false and misleading. For a defect in disclosure to be "material" in relation to this regulatory purpose, it must be shown that the "free exercise of the voting rights of stockholders" had been "frustrated" because the stockholders lacked an explanation as to the "real nature of the questions" on which they were asked to vote. *J. I. Case Co.* v. *Borak, supra,* 377 U. S. at 431.

Thus, under SEC's proxy rules the focal point in preparing every proxy statement is the materiality[15] of the information, not merely its relevancy. Rule 14a-9 is violated only where both the omitted fact is important and where its omission makes a proxy statement false and misleading.

A proper standard of materiality in this context must take into account not only the protection of investors but the necessity of having a realistic and attainable standard for preparation of such documents.

Compliance with the doctrine of "equal emphasis", whereby certain disclosures which bear upon other disclosures must be given similar attention within the confines of a proxy statement, would present an impossible challenge if the views of the court below prevail and it becomes necessary to present reams of cumulative, near-trivial, detailed data in an effort to accomplish disclosure of all relevant material. Proxy statements which now run 80 to 100 pages would run several hundred pages. Even the most tolerant, reasonable and prudent shareholder would not then read them.

The SEC has repeatedly urged adherence to the fundamental concept that disclosure statements must be clear, concise and

---

15. SEC uses the term "materiality" to convey essentially the same concept as in modern tort or contract law—a matter to which a reasonable man would attach importance in determining his choice of action in the transaction in question. *Restatement of Torts,* § 538; III Loss, *Securities Regulation* (2d Ed. 1961) p. 1431; also SEC's first decision on this issue: *In the Matter of Charles A. Howard,* 1 S. E. C. 6 (1934).

readable.[16] Admittedly, complicated transactions between large business concerns will require significant space to properly explain to investors. However, the very purpose of providing fair corporate suffrage with respect to every publicly-held equity security will be thwarted if proxy statements must be encyclopedias prepared by attorneys and accountants solely with an eye to protecting against other attorneys seeking to find factual omissions which are of no practical significance except that they may be considered relevant and a stepping stone to private litigation.

C.

Materiality Means Importance and a Strong Likelihood of Impact on the Reasonable Shareholder.

Mr. Justice Harlan struck an appropriate balance when he emphasized in *Mills* that omitted material to be "material" must be such as to have a *significant propensity* to affect the voting process.[17] 396 U. S. at 384-85. Similarly, Judge Friendly in

16. Securities and Exchange Commission Guides for Preparation and Filing of Registration Statements, Guide No. 5, Securities Act Release No. 4936, as amended, states:

> "In order to make prospectuses more readable and understandable, and therefore more useful, registrants should limit their length and complexity by careful organization of the material, . . . and the avoidance of . . . *unnecessary detail.*" [Emphasis added.]

Schedule 14A, Item 14, which sets forth the applicable requirements for disclosure of the transaction between National and TSC emphasizes:

> "(a) Outline briefly the material features of the plan. . . .
>
> (b) . . . What is required is information essential to an investor's appraisal of the action proposed to be taken."

17. The Court of Appeals below was "convinced that the test we adopt is supported by the reasoning of the Supreme Court in *Mills* and in Affiliated Ute [because it] would make little sense to hold that causation is established by a more lenient standard then materiality." 512 F. 2d at 331. However, that is exactly what this Court took great pains to point out in *Mills* and *Affiliated Ute*—that it makes a great deal of sense, from a policy standpoint, not to require difficult causation proofs once materiality is established. Neither

Gerstle v. *Gamble-Skogmo, Inc.*, 478 F. 2d 1281, 1302 (2d Cir. 1973) rejected a concept of materiality which is simply suggestive of a mere possibility, however unlikely. In addition, Judge Wisdom in *Smallwood* v. *Pearl Brewing Co.*, 489 F. 2d 579, 604 (5th Cir. 1974), *cert. denied*, 419 U. S. 873 (1974), emphasized that he found no evidence in *Mills* of any desire by this Court to relax the standard of materiality to a mere possibility of influence upon a reasonable investor.

Thoughtfully, the Second Circuit in *Gerstle* and the Fifth Circuit in *Smallwood* defined materiality in terms of what *would* be important to shareholders in deciding how to vote, not simply what *might* be important to them. Another articulation of this same realistic concept of materiality was set forth in *General Time Corporation* v. *Talley Industries, Inc.*, 403 F. 2d 159, 162 (2d Cir. 1968), *cert. denied*, 393 U. S. 1026 (1969), namely:

> "The test, we suppose, is whether, taking a properly realistic view, there is a substantial likelihood that the misstatement or omission may have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course."

In essence, a standard tending toward probability rather than the mere possibility of effect upon a shareholder's decision is what this Court should confirm as the appropriate standard.

Mills nor *Affiliated Ute* meant to eliminate the need in determining materiality that there be real probability an omitted fact would affect a voting (or investment) decision. *Mills* and *Affiliated Ute* say that once enough probability to establish materiality is shown, in appropriate circumstances it is not necessary to go further and prove causation. That in no way supports the Seventh Circuit's proposition that because probability is not an element of causation, it is, *a fortiori*, not a materiality element. On the contrary, this Court's emphasis on "significant propensity" appears to be predicated upon the fact that once the requirement for proof of causation is eliminated, the standard for materiality becomes all the more important. This is vital to avoid rescission of transactions or the imposition of damages on the basis of defects too insignificant to have an impact on the voting process.

Other Courts of Appeals have adopted the "would" test rather than the Seventh Circuit's "might" test in the related area of liability under Section 10(b) of the 1934 Act and Rule 10b-5.[18] The "would" test has also been adopted in determining liability for defective tender offers under Section 14(e) of the 1934 Act.[19] It has also been adopted under Section 12(2) of the Securities Act. *Johns Hopkins University* v. *Hutton*, 422 F. 2d 1124 (4th Cir. 1970).

The test of materiality used by other Courts of Appeals is consistent with SEC's definition of the term "material" which limits information required to be disclosed to matters of importance to the average reasonable shareholder.[20]

In 1934 Congress saw a way to avoid many of egregious injustices then being done to the average capital investor and declared that such corporate "secrets" as then made those injustices possible must be disclosed fairly. This same concern with public disclosure of important corporate developments which induce investors to act is the dominant theme in three major post-1934 materiality cases, *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (2d Cir. 1968), *cert. denied sub nom., Coates* v. *S. E. C.*, 394 U. S. 976 (1969); *In re Cady, Roberts & Co.*, 40 S. E. C. 907 (1961);

18. *Titan Group, Inc.* v. *Faggen*, 513 F. 2d 234 (2d Cir. 1975); *Robinson* v. *Cupples Container Co.*, 513 F. 2d 1274 (9th Cir. 1975); *Marx* v. *Computer Sciences Corp.*, 507 F. 2d 485 (9th Cir. 1974); *Gordon* v. *Burr*, 506 F. 2d 1080 (2d Cir. 1974); *Harnett* v. *Ryan Homes, Inc.*, 496 F. 2d 832 (3d Cir. 1974); *Vohs* v. *Dickson*, 495 F. 2d 607 (5th Cir. 1974); *Rochez Bros., Inc.* v. *Rhoades*, 491 F. 2d 402 (3d Cir. 1974); *Arber* v. *Essex Wire Corp.*, 490 F. 2d 414 (6th Cir. 1974), *cert denied*, 419 U. S. 830 (1974); *John R. Lewis Inc.* v. *Newman*, 446 F. 2d 800 (5th Cir. 1971); *Herpich* v. *Wallace*, 430 F. 2d 792 (5th Cir. 1970).

19. *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F. 2d 341 (2d Cir. 1973), *cert. denied*, 414 U. S. 910 (1973); *Gulf & Western Industries, Inc.* v. *Great A. & P. Tea Company, Inc.*, 476 F. 2d 687 (2d Cir. 1973); *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F. 2d 937 (2d Cir. 1969).

20. SEC Rules 405(1), 408, 12b-2(j); respectively, 17 C. F. R. §§ 230.405(1), 230.408, 240.12b-2(j).

and *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 1934 Act Release No. 8459 [1967-1969 Transfer Binder], CCH Fed. Sec. L. Rep. ¶ 77,629 (November 25, 1968).[21]

Materiality must be so defined that it limits required disclosures to those facts which are important to the reasonable shareholder and investor. The relative importance of any particular information can be determined by its likelihood to affect the shareholder/investor's decisions. Only when required disclosures are so restricted is the mandated disclosure fair as well as full.

II.

Within This Summary Judgment Record and Under a Proper Test of Materiality, None of the Complained of Omissions Is Material as a Matter of Law.

This matter comes before the Court on a summary judgment record; therefore, to prevail Northway must show there are no genuine issues of material fact and the omissions were so important that the Proxy Statement was thereby rendered false and misleading in violation of Rule 14a-9.

Ordinarily, materiality of an omission is a question of fact, to be determined by the trier of fact. Only when reasonable men may not differ on the issue of materiality can it be determined as a matter of law. *Johns Hopkins University* v. *Hutton*, 422 F. 2d 1124, 1129 (4th Cir. 1970); *Rogen* v. *Ilikon Corp.*, 361 F. 2d 260, 266 (1st Cir. 1966). Moreover, if different permissible inferences may be drawn from the underlying facts or if

21. In *Texas Gulf Sulphur*, insiders artfully delayed disclosure of one of the greatest mineral finds of all time. In *Cady, Roberts*, an insider and his associates liquidated stock positions before the trading market learned that a big industrial corporation had passed its dividend. It is not surprising that in *Merrill Lynch*, SEC found the securities firm seriously at fault where a few preferred customers gained the benefit of liquidating positions and short sales in Douglas Aircraft's stock as Merrill Lynch's preferred customers while the general public remained unaware of a disastrous drop in Douglas Aircraft's earnings.

there are gaps in the summary judgment record, no summary judgment may be granted. *Adickes* v. *S. H. Kress & Co.*, 398 U. S. 144 (1970); *United States* v. *Diebold, Inc.*, 369 U. S. 654, 655 (1962). Accordingly, whenever different inferences reasonably may be drawn from the underlying facts, those most favorable to TSC and National must be assumed.

Northway asserted that the Proxy Statement was deficient in many respects because it failed to state facts claimed to be material as a matter of law. Many of the asserted defects have been abandoned by Northway or rejected below and are not presently before this Court. The remaining four omitted factual matters were found by the court below to be material as a matter of law. 512 F. 2d at 324.

The rationale of the Court of Appeals, as to each of the four omissions it found material as a matter of law, actually involved one or more of the following shortcomings: (i) a real dispute over genuine issues of material fact, (ii) a dearth of evidentiary facts, permitting one to draw equally plausible inferences that such omissions were not material, or (iii) the omission of cumulative, relatively unimportant information which was of little interest to most reasonable shareholders.

There is no evidence that TSC and National consciously withheld any material information from shareholders or that the Proxy Statement was prepared with a reckless disregard for important facts. To the contrary: it is clear that the Proxy Statement was drafted by reputable attorneys in a professional manner (A. 95).

The Proxy Statement was duly submitted to the SEC's Division of Corporate Finance in preliminary form. That Division of the SEC was familiar with the recent registration statements, periodic reports and proxy statements filed by National and TSC, including those in early 1969 in which the equity interest of National in TSC was first disclosed. The SEC's Corporate Finance Division replied in a 3-page comment letter

which took no exception whatever to any of the alleged defects about which Northway complained in the Court of Appeals (A. 96-100).

A.

Omission of a Statement That Stanley R. Yarmuth Was Chairman of the Board of TSC and That Charles F. Simonelli Was Chairman of the TSC Executive Committee Was Not Material.

Although the Court of Appeals agreed with District Judge McLaren's finding that whether National was in control of TSC was genuinely in dispute (512 F. 2d at 329), the court below was persuaded that the Proxy Statement became fatally defective under Rule 14a-9 for want of recitations that National's President, Stanley R. Yarmuth, had been elected Chairman of the Board of TSC and National's Executive Vice-President, Charles F. Simonelli, acted as Chairman of the TSC Executive Committee. The panel found these omissions were material as a matter of law "[b]ecause these facts[22] were persuasive indicators that the TSC board was in fact under the control of National, and that National thus 'sat on both sides of the table' in setting the terms of the exchange. . . ." 512 F. 2d at 333. Neither the materiality of these omissions nor the conclusion is supported by the summary judgment record or by logic.

There is no evidence that the terms of the transaction were set by the same persons sitting on both sides of the table. Neither Mr. Yarmuth nor any other National representative negotiated the terms of the transaction on behalf of TSC. On the contrary there is credible, uncontroverted deposition testimony that Mr. Noyes and TSC's aggressive President, Mr. Richard H. Schaefer, negotiated terms of the transaction effectively on behalf of TSC and its shareholders. The terms of the transaction grew out of a proposal made by National to Hornblower, which was acting as the investment banking representatives and advisors of the TSC Board of Directors. Blancke Noyes was a

22. Coupled with the omission discussed at pp. 32-34 hereof.

partner in the Hornblower firm and it was he who informed National that their original proposal was insufficient and suggested the actual terms of the transaction as being a fair offer. National accepted the Hornblower counter-proposal without any negotiation.[23] Moreover it was Schaefer who actually worked with Noyes in representing the interests of TSC in the negotiations with National (A. 101).

Nor could the court below properly ground its holding on this point upon potential influence which National might have exercised upon the decision of the TSC Board to approve and proceed with this transaction. Only directors not affiliated with National voted for the resolutions at the October 16, 1969 TSC Board meeting. 512 F. 2d at 328. The significant facts, admittedly disclosed in plain language in the Proxy Statement, sufficiently alerted every reasonable TSC shareholder to the fact that National had a substantial influence on the TSC Board when five of the ten TSC directors were plainly identified as National's nominees.

The Proxy Statement (A. 267-68) set forth prominently under separate headings at pages 6 and 7, first, the approval by the TSC Board of Directors of the sale to National and, immediately thereafter, a paragraph setting forth the fact that National owned approximately 34% of the outstanding voting stock of TSC. Then in the succeeding paragraph, five out of ten members of the TSC Board were described as National's nominees. It was expressly stated that Mr. Yarmuth was President and a director of National and that Mr. Simonelli was Executive Vice-President and a director of National. These disclosures were plainly spelled out in three successive paragraphs, on page 6 of the Proxy Statement, and the facts were flagged with headings in equally-sized bold face type as follows:

BOARDS OF DIRECTORS APPROVAL

* * *

23. A. 413.

NATIONAL'S EQUITY INTEREST IN TSC

* * *

NATIONAL'S NOMINEES ON TSC'S BOARD

Obviously every reasonable TSC shareholder, after reading these paragraphs and knowing of National's 34% voting power in TSC, was sufficiently informed that National had a position of influence on the TSC Board of Directors which approved the transaction and recommended it to TSC's shareholders. As a result, this same reasonable TSC shareholder had material facts sufficient for determining the weight to be given to the TSC Board's approval of the transaction. The additional revelation that Messrs. Yarmuth and Solomon were respectively the Chairman of the TSC Board and of its Executive Committee would have merely been cumulative.

Whatever may be said of the relevancy of such additional information with respect to Messrs. Yarmuth and Simonelli, it can hardly be said that as a matter of law this additional information would have had a significant propensity to affect the voting of TSC shareholders; the record on summary judgment does not permit drawing a conclusion as to the materiality of these admittedly omitted facts.

The Court of Appeals drew its inferences on the basis of the titles without reference to what in fact were the functions actually performed by the persons involved, including Schaefer who was TSC's active full-time executive. In fact, there was no specific provision in the TSC by-laws for an executive committee although there was provision for the Board to select and act through committees of its choosing from time to time. Not only was there a lack of a specific provision for an executive committee, but there was no indication that the person who acted as chairman of an executive committee thereby became an "officer" of the corporation (A. 442-43, 444-48).

Only by stretching its "relevancy" test wide enough to cover all the factual gaps in the summary judgment record could the

panel of the court below conclude that omission of a recitation of the titles of Messrs. Yarmuth and Simonelli in the section of the Proxy Statement discussing the TSC Board of Directors was material as a matter of law.

B.

Omission of Reference to Prior SEC Filings of National and TSC Which Stated National "May Be Deemed to Be a Parent" of TSC Was Not Material.

National's acquisition of the Schmidt TSC stock in February, 1969, required it to file a Form 13D with SEC because it had obtained in excess of 10% of the voting stock of TSC. In its Form 13D National answered Item 4 by stating it had acquired approximately 33% of the outstanding voting shares of TSC, and "accordingly, National *may be* deemed to be a 'parent' of TSC as that term is defined in the rules and regulations under the Securities Act of 1933." [Emphasis added.] (A. 473.) National made this statement based solely upon its stock ownership in TSC. In February, 1969 there was no other relationship whatever between the two corporations.[24]

Both the Court of Appeals and the District Court found the alleged control of TSC by National was an unreconciled material fact question on the summary judgment record which should be left to the trier of fact. Hence the court below lacked the factual data required to assess the importance of the prior SEC filings.

The Court of Appeals could not and did not hold that, if disclosed, the recital contained in earlier SEC filings (13D and 8-K) that "National may be deemed a parent of TSC", would

24. TSC's Form 8-K for the month of February, 1969 was required because Schmidt's control of TSC had ceased upon National's purchase of Schmidt's stock and the resignations of TSC founder Schmidt and his son from the TSC Board. Its Form 8-K incorporated a similar statement which was contained in Item 3(a) of the TSC annual report on Form 10-K for the year ended October 31, 1968; namely, the stock purchased, coupled with cessation of Schmidt's control of TSC as its founder, gave rise to a possibility that National "may be" deemed a parent of TSC. (A. 517.)

have revealed National's control. Instead the court below merely ascribed significance to such disclosure as bearing on National's position of influence in TSC. 512 F. 2d at 333. This had been done in the Proxy Statement by the plain, prominent and accurate disclosures of National's five nominees on the TSC Board and its 34% ownership of TSC's voting stock, the sole fact upon which the recital in the SEC filings was based.

The only way to gauge actual control is by putting it to the test in a dispute situation. Since National and the old TSC management led by Schaefer never drew any clear-cut battle lines, no one ever really knew who could ultimately control TSC during the entire period between the Schmidt purchase and consummation of the shareholder-approved purchase of TSC's assets. National would have taken a substantial risk if it presented information leading readers to conclude National *did* have control—for National shareholders also had to approve the transaction described in the joint Proxy Statement. If "some few" National shareholders then arguably voted for the transaction based on an incorrect inference that their management was in control of the negotiations, they could seek to impose liability on National for the subsequent marked decline in National Common Stock.

National had a choice of doing one of two things: (i) refrain from making any conclusory statements about control, or (ii) make the disclosures the Court of Appeals would require—along with a disclaimer of knowing who *actually* controlled TSC. Manifestly, it would have been misleading not to make such a disclaimer without actual knowledge. The Proxy Statement reflects the sensible choice actually made in November, 1969; the latter course (ii) would have risked confusing shareholders. Indeed, in October, 1969 when Hornblower told National that its exchange offer was insufficient and made a specific counter-proposal, National accepted Hornblower's counter-proposal without further discussion. At the very least this tended to show that National was not in control of TSC at that

point in time because it was TSC's representatives who fixed the terms of the transaction.

Finally, it is not surprising that the representatives of TSC and National did not see a need to state in the Proxy Statement that National might be deemed to be a parent of TSC as they had recited in their required filings in February and March of 1969. There was no requirement for any such recital in any of the various items in Schedule 14A of the proxy rules, but both corporations believed this type of recital was appropriate in a required filing (Form 8-K) when the control of TSC by Schmidt ceased and, as to National, when it acquired 33% of the voting stock (Form 13D) from founder Schmidt and members of his family. TSC and National had already made these disclosures at the time and in the way they were required to be made under the applicable rules of SEC. With the alleged control of TSC by National a hotly disputed question of material fact, the holding by the Court of Appeals that this omission was a material defect in the Proxy Statement as a matter of law lacks any rational basis.

C.

Omission of Reference to the Hornblower Opinion on Value of National's Warrants Was Not Material.

The Hornblower opinion to the TSC directors on the fairness of the transaction to TSC's stockholders was referred to directly at page 6 of the Proxy Statement where it was disclosed:

> "In such opinion, said firm considered, among other things, the current market prices of the securities of both corporations, the high redemption price of the National Series B Preferred Stock, the dividend and debt service requirements of both corporations, *the substantial premium over current market values represented by the securities being offered* to TSC stockholders and the increased dividend income." [Emphasis added.] (A. 267.)

The Hornblower investment banking firm had made a detailed examination of the merits of the TSC and National securities in September and October, 1969, well in advance of the November 12, 1969 Proxy Statement. Blancke Noyes, who was a partner in the Hornblower firm, continued as a TSC director after National's acquisition of the Schmidt stock in February, 1969. It was Mr. Noyes, his partners and the Hornblower employees who actually determined the exchange ratio which became the crux of the transaction between National and TSC (A. 413).

At TSC's request, Mr. Noyes' firm gave the TSC Board a favorable written opinion on the fairness of the transaction to TSC shareholders (A. 427). This written report by the Hornblower firm was discussed during the October 16, 1969 TSC directors' meeting and Mr. Noyes explained the analysis supporting his firm's appraisal, including the fact that the exchange ratio represented more than a 40% premium to the TSC stockholders based on *current market values.* Noyes also pointed out that it was his firm which had suggested the present exchange ratio as being a fair offer and that National had accepted their proposal without any negotiation.

After explaining that his firm appraised the National $1.25 Series B Preferred as a sound value, Noyes indicated that even though there might be some decline in the price of the Warrants, the exchange offer was a fair one. Following this and other explanations of the proposed transaction, the required resolutions were adopted by unanimous vote of four disinterested TSC directors who voted on the transaction.

Prior to the transaction only 487,000 of National's Warrants were listed on the American Stock Exchange. The transaction called for National to issue approximately 2.6 million additional Warrants in connection with the transaction following the shareholders' meetings on December 5, 1969. Accordingly, National needed an independent, outside opinion on the intrinsic value of the Warrants which it would issue to TSC

stockholders in the transaction. Late in October, 1969, Hornblower was requested by National to give National a written opinion on the value of the National Warrants which National could use in booking the transaction on its financial records. Hornblower gave National its written opinion, dated October 31, 1969, on the intrinsic value of the National Warrants as of October 9, 1969, taking into account not only all the conventional factors in valuing warrants but also the fact that approximately 2.6 million additional Warrants would be issued in connection with the acquisition (A. 519).

It was this subsequent Hornblower opinion to National which the court below erroneously said contained "bad news" about the National Warrants and which the court concluded should have been disclosed in the Proxy Statement because it was material as a matter of law. 512 F. 2d at 331, 335.

To reach this conclusion the Court of Appeals had to make several inferences which were not justifiable on the summary judgment record. The court below first inferred a prediction of future market values from the recital of the factors considered by the Hornblower firm on page 6 of the Proxy Statement: current market prices of the securities of both corporations, the high redemption price of the National Series B Preferred Stock, the dividend and debt service requirements of both corporations, the substantial premium over current market values represented by the securities being offered to TSC stockholders, and the increased dividend income.

The table of stock prices on page 10 of the Proxy Statement showed market prices of all pertinent securities of both corporations at January 1, 1967 and the final entry was market prices as of November 7, 1969, all as required by Schedule 14A. Although many other inferences were more readily discernible, the Court of Appeals concluded that there was a prediction of future market prices implicit in "linking the evaluation of the proposed exchange to current market values", 512 F. 2d at 334. Then, the court below proceeded to confuse

two very different things: (i) the October 16, 1969 written Hornblower opinion to the TSC Board on the fairness of the transaction which included comparative current market prices as a factor considered by Hornblower in reaching its conclusion on the fairness of the transaction, and (ii) the October 31, 1969 Hornblower letter to National on intrinsic value of the Warrants which was needed by National in order to put the transaction on National's books. In so doing the Court of Appeals, even though working with a summary judgment record, ignored the differences between market prices and intrinsic value and drew an inference favorable to Northway on its summary judgment motion as to liability of TSC and National.

Page 10 of the Proxy Statement reflected recent market prices of the TSC Common and Preferred Stock and National's Warrants and Series B Preferred which were to be exchanged for TSC assets in the transaction. Recent market prices on National's Common Stock were also scheduled. These were required disclosures under the proxy rules.[25]

The Proxy Statement properly referred to market prices and Hornblower spoke of current *market* prices of the securities of both companies as a factor considered in reaching its favorable opinion.[26]

Hornblower's later opinion to National shows plainly it focused on value, not market price, and certainly not market price at any future date. That Hornblower's evaluation was made "in light of the fact that approximately 2.6 million additional Warrants will be issued later in 1969 in connection with the acquisition," might only imply that Hornblower gave particular emphasis to one of several factors contributing to the Warrants' intrinsic value. The Seventh Circuit's misreading of the record on this point becomes apparent from the penultimate paragraph of the letter, namely:

25. Section 14(a) of the Act and Schedule 14A, Item 14(c), 17 C. F. R. § 240.14a-101, Item 14(c).

26. A. 427.

> "After studying the price relationships of other warrants traded publicly, referring to customary systems of warrant evaluation, and considering the particulars of the proposed acquisition, we concluded that the warrants in question had a value of approximately $3.50."

There was no prediction of a future market price but a determination of intrinsic value of the Warrants which National needed for accounting purposes in recording its acquisition of TSC's assets in a taxable transaction (A. 148-51, 154-56).

This later Hornblower letter did not contradict or take issue with the points made in its prior written opinion to the TSC directors nor did it conflict with the recitations in the Proxy Statement as to factors which Hornblower had taken into account in reaching its conclusion on the fairness of the transaction. The letter to National dealt only with "intrinsic value" of the National Warrants and did not speak to current market prices of the National Warrants or make any prediction of the future market prices of the same security.

It should have been impossible to conclude that the October 31, 1969 letter to National on the value of the Warrants conflicted with or contradicted the earlier opinion based on different premises, *i.e.*, comparative market values. Indeed disclosure of the subsequent Hornblower opinion on intrinsic value of the Warrants would have been mischievous, unless similar evaluations were made and disclosed with respect to all of the other securities of TSC[27] and National involved in the transaction. This surely would have brought down the wrath of SEC when most of the securities were actively traded on the New York and American Stock Exchanges, both of which gave objective daily evidence of market prices.

At most the later Hornblower opinion on the value of the Warrants created an ambiguity which should not and could not

27. In fact, the present state of the record permits (if not requires) the assumption that Petitioners could show at a trial that there were indications that market prices of TSC's securities could be expected to decline further. See, *e.g.*, *Adickes* v. *S. H. Kress & Co.*, 398 U. S. 144 (1970).

be resolved on a summary judgment record. These matters could only be determined by the jury after hearing all the evidence, which would include hearing the testimony of the author of these letters regarding his reconciliation of the claimed difference or conflict between them and judging his credibility, and also hearing the expert testimony by others on the issue. Only then, after the jury had had an opportunity to assess whether a serious conflict or ambiguity actually existed, could a determination of the materiality of this second Hornblower letter properly be made. Judge McLaren correctly so held and characterized this issue as unripe for decision on Northway's summary judgment motion. 361 F. Supp. at 116.

D.

Omission of Reference to Purchases of National's Common Stock by Madison Fund, Inc. and the Method of Disclosing National's Own Purchases of Its Common Stock Was Not Material.

The Court of Appeals found that on the summary judgment record there was a material non-disclosure and that Rule 14a-9 was violated because the Proxy Statement failed to recite purchases by Madison Fund, Inc. ("Madison") of National Common Stock during 1968-1969, and also failed to make more prominent disclosures of purchases of National Common Stock by National itself. 512 F. 2d at 335-36.

Northway, in support of its summary judgment motion, asserted and argued that Madison and National had conspired to purchase National Common Stock in "coordination" which, in turn, would be significant to a shareholder in assessing the recent market prices of National Common Stock which were shown in the Proxy Statement. Northway alleged this conspiracy could be inferred from the following facts: Edward Merkle who was the President of Madison was a consultant of National receiving $12,000 per year and Bernard H. Barnett, who was Chairman of National's Board of Directors, was also a director

of Madison. During the period January 1, 1969 to October 17, 1969, National purchased 48,300 shares of its Common Stock or 2.4% of reported market transactions in that period.[28] Madison's purchases of National Common Stock in the same period were 54,400 shares or approximately 2.5% of reported market transactions.

National sold none of such stock during the period and made no further purchases of its Common Stock between September 17, 1969 and late December, 1969, subsequent to the December 5, 1969 shareholders' meetings at which the transaction was approved. In spelling out the underlying facts Northway also brought out that during 1968 Madison had purchased National debentures which were publicly offered through underwriters in October, 1968 and that it also purchased certain National Common Stock during 1968.

Northway also argued that the purchases by Madison were more prevalent at times when the market price of National Common was being used to fix an exchange ratio in other National acquisitions. Despite the extended depositions taken by Northway it found no other evidence to support its charge of collusive purchases, although Northway did suggest that there was a pattern in the purchases of National Common by National and Madison indicating that neither of them purchased during a period in which the other was purchasing.

In order to reach a conclusion of violation of the proxy rules Northway urged a Rule 10b-5 manipulation and then characterized it as a Rule 14a-9 non-disclosure because it was asserted that the alleged market rigging (if it in fact occurred) would have made the market prices shown in the Proxy State-

28. National's open market purchases of its Common Stock for the period January 1, 1966 through June 30, 1969, were set forth in the "Statements of Consolidated Stockholder's Equity" on pages 62-63 of the Proxy Statement and "Note J-Subsequent Events" on page 69 states: "From June 30, 1969 through September 30, 1969, National has purchased 27,500 shares of its Common Stock on the open market for an aggregate price of $280,000." (A. 323-24, 330)

ment misleading since shareholders were entitled to assume that the prices were the product of a free and unmanipulated public securities market.

Opposing Northway's summary judgment motion, TSC and National argued and supported with uncontroverted affidavits and deposition testimony that there was no plan or conspiracy to manipulate the market in National Common Stock; also that Messrs. Solomon and Yarmuth did not know of Madison's purchases of National Common Stock until stock transfer sheets showed they had taken place.[29] Barnett's affidavit showed that he did not know of Madison's purchases of National Common until he and other directors of Madison received regular portfolio transaction reports in their role as Madison's Board of Directors (A. 93).

District Judge McLaren found that Northway's evidence in opposition to Northway's motion succeeded in raising a genuine issue of fact as to whether the Madison purchases were in fact coordinated with those of National, although he observed there was some evidence to support an inference of coordination in purchases. However, after noting other credible, conflicting evidence, the District Judge determined that he could not arbitrarily pick the inference favorable to Northway as the moving party under Rule 56 and held that this issue must remain for the trier of fact. 361 F. Supp. at 116.

The Court of Appeals agreed, though apparently reluctantly, that collusion was not established. 512 F. 2d at 336. Nonetheless, the court below went on to find that what was established, though falling short of collusion, was suggestive of manipulation and should have been put in the Proxy Statement for the TSC stockholders to judge from those facts whether a manipulation had occurred!

The proposed transaction called for an exchange of National Warrants and Series B Preferred Stock (not Common Stock), for TSC Common Stock and Series 1 Preferred Stock. There

29. A. 103, 105.

is no evidence in the record that any of those securities were purchased by National or Madison. There is no evidence of a direct relationship between the market price of National Common and National Warrants. Northway's own expert, Professor Nemmers, treated the Warrants as "highly speculative" and indulged in at least three different identifiable exercises trying to develop a value (A. 538). Mr. Noyes clearly refused to regard the value of the Warrants as "dependent" on the price of the Common Stock (A. 140).

As to the National Series B Preferred, all the evidence is that the determinative factors were its dividend, yield and/or coverage (A. 136; 160-63; 199-201). National did not purchase any of its Common Stock in the market from September 17, 1969, to December 18, 1969, almost two weeks after the stockholders' meetings of December 5, 1969 (A. 90).

Apart from Northway's argument, there is nothing in the record that either National or Madison Fund purchased National Common for any reason other than their own respective proper corporate or investment purposes, unilaterally and independently determined, and there is a dearth of evidence that either sold any stock so purchased or otherwise engaged in manipulation. There was no showing that any purchase by either National or Madison, or all of such purchases, materially affected the market price of National Common on any day, week or month, or in any way affected the trend of high and low sales prices fully and fairly disclosed on page 10 of the Proxy Statement.[30]

The court below also failed to appreciate that any such disclosure would compel National in effect to try, via proxy material, the fact or issue of collusion before a jury of shareholders, because to disclose bits and pieces of circumstantial evidence, without denying the inference of collusion, would invite a stockholder to draw the worst possible inference on the basis of a lopsided disclosure.

30. A. 107, Chart facing 108.

CONCLUSION.

For the foregoing reasons TSC and National respectfully urge that the decision and judgment of the Court of Appeals for the Seventh Circuit on liability of these Petitioners be reversed and that the judgment and Order of the United States District Court denying Respondent's motion for summary judgment as to liability of corporate defendants be reinstated.

Respectfully submitted,

JOSEPH N. MORENCY, JR.,
JAMES T. OTIS,
WESLEY S. WALTON,
JOHN R. F. BAER,
Price, Cushman, Keck, Mahin
& Cate,
8300 Sears Tower,
233 South Wacker Drive,
Chicago, Illinois 60606,
312/876-3400,
Attorneys for Petitioners.

Of Counsel:
MILTON V. FREEMAN,
WERNER J. KRONSTEIN,
Arnold & Porter,
1229 Nineteenth Street, N. W.,
Washington, D. C. 20037.

November 20, 1975.

APPENDIX.

SECURITIES EXCHANGE ACT OF 1934, SEC. 14(a), 15 U. S. C. § 78n(a).

§ 78n. Proxies.

(a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title.

SECURITIES AND EXCHANGE COMMISSION, RULE 14a-9, 17 C. F. R. § 240.14a-9.

§ 240.14a-9 False or misleading statements.

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

(b) The fact that a proxy statement, form of proxy or other soliciting material has been filed with or examined by the

Commission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein or any matter to be acted upon by security holders. No representation contrary to the foregoing shall be made.

NOTE: The following are some examples of what, depending upon particular facts and circumstances, may be misleading within the meaning of this section:

(a) Predictions as to specific future market values, earnings, or dividends.

(b) Material which directly or indirectly impugns character, integrity or personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation.

(c) Failure to so identify a proxy statement, form of proxy and other soliciting material as to clearly distinguish it from the soliciting material of any other person or persons soliciting for the same meeting or subject matter.

(d) Claims made prior to a meeting regarding the results of a solicitation.

SECURITIES AND EXCHANGE COMMISSION,
RULE 12b-2(j), 17 C. F. R. § 240.12b-2(j).

(j) *Material.* The term "material", when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before buying or selling the security registered.

SECURITIES AND EXCHANGE COMMISSION,
RULE 405(a), (f) and (n), 17 C. F. R. § 230.405(a), (f) and (n).

§ 230.405 Definitions of terms.

Unless the context otherwise requires, all terms used in §§ 230.400 to 230.494, inclusive, or in the forms for registration have the same meanings as in the act and in the general rules and regulations. In addition, the following definitions apply, unless the context otherwise requires:

(a) *Affiliate.* An "affiliate" of, or a person "affiliated" with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

* * * * *

(f) *Control.* The term "control" (including the terms "controlling", "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

* * * * *

(n) *Parent.* A "parent" of a specified person is an affiliate controlling such person directly, or indirectly through one or more intermediaries.

FEDERAL RULES OF CIVIL PROCEDURE, RULE 56(a), (b) and (c).

Rule 56.

SUMMARY JUDGMENT.

(a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in his favor upon all or any part thereof.

(b) For Defending Party. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.

(c) Motion and Proceedings Thereon. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.